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No. 93-995

In The

Supreme Court of the United States

October Term, 1993

HOME BUYERS WARRANTY CORPORATION II, and NATIONAL HOME INSURANCE COMPANY,

Petitioners,

v.

JULIETTE G. LOPEZ,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of Alabama

REPLY TO BRIEF IN OPPOSITION

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REPLY TO BRIEF IN OPPOSITION

Petitioners file this reply to issues raised in the Brief in Opposition, and to call the Court's attention to still another Alabama Supreme Court decision showing how

that Court has dug in its heels over its restrictive reinterpretation of "involving commerce" under the Federal Arbitration Act (the "FAA").[1]

I. Contrary to respondent's allegations, petitioners focus on the legal interpretation of "involving commerce" under the Federal Arbitration Act

Respondent resorts to two principal devices in an attempt to trivialize the issues raised by this petition.

First, respondent wrongly contends that petitioners focus on the facts of her individual case, rather than upon the broader legal issue raised by the Alabama Supreme Court's impermissibly restrictive reinterpretation of "involving commerce" under the FAA. The truth is that petitioners seek review at a cost many times what the limited Lopez claim is worth precisely because their interest was and is almost exclusively in the jurisdictional reach of the FAA, not only in Alabama but throughout the nation. As the petition shows, petitioner HBWC, from Denver and its several regional offices, services warranties issued in all 48 contiguous states by the 12,000 homebuilder members of its BSSI II affiliate, while petitioner

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[1] The present case has now been officially reported at 628 So.2d 361 (Ala. 1993). Petitions seeking review of two more of the Alabama Supreme Court decisions of last summer applying its restrictive interpretation of "involving Commerce" under the FAA to deny enforcement of pre-dispute arbitration agreements are now pending. They are *The Terminix Int. Co. LP v. Jackson*, and *Allied-Bruce Terminix Cos. v. Dobson*, Nos. 93-1000 and 93-1001.

NHIC insures these thousands upon thousands of warranties. No one claim on any single warranty is materially significant compared to the legal issues raised by the decision below.

Petitioners seek review here solely because it is critically important to them whether the FAA applies uniformly in all states to compel enforceability of the warranties' pre-dispute arbitration clause, and to bring to bear the growing body of federal law this Court has developed around the FAA. Unless this Court intervenes, the arbitration provisions integral to the warranties are simply unenforceable in Alabama. They may also cease to be enforceable in those states (like Nebraska and Mississippi) which share Alabama's hostility to pre-dispute arbitration agreements.[2] And the growing body of federal common law of arbitration developed by this Court since *Prima Paint* may become inapplicable to these and similar agreements in any state which chooses to adopt the restrictive Alabama test. That's why petitioners seek review here.

This case presents a clean vehicle for assessing the Alabama Supreme Court's reinterpretation. Petitioners have no local presence. The warranty in question requires that representatives of the Colorado company inspect the house, with claims to be processed either in Denver or at the regional office in Tucker, Georgia. As was required, respondent sent her claim to the Georgia office, and received responses from Denver. Both the circuit court

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[2] *State v. Nebraska Assn. of Public Employees*, 477 N.W.2d 577 (1991); *McClendon v. Shutt*, 115 So.2d 740 (Miss. 1959).

and the dissenters in the Alabama Supreme Court expressly concluded that the FAA was applicable on these facts, under the broad jurisdictional test which the Alabama Supreme Court had previously endorsed.

Second, respondent tries to confuse and obscure what the Alabama Supreme Court did last summer. To this end, petitioner attempts to shift focus from the restrictive jurisdictional test formally adopted by the Alabama Supreme Court in a sextet of cases (three of which she fails to cite or discuss, and three of which are now before this Court), to an irrelevant quarrel over whether courts are able to use the "contemplation" test to narrow or expand the reach of the FAA.

Here, there is no need to speculate about what the Alabama Supreme Court intended to do or what it did. In the six cases decided last summer, the Alabama Supreme Court majority openly and frankly announced that it was overruling the broad jurisdictional test it had previously applied in the general run of FAA cases in favor of a decidedly more restrictive test – whether the parties "contemplated substantial interstate activity" – previously applied only rarely. And it openly admitted that it was doing so in order better to implement Alabama's public policy hostile to enforcement of pre-dispute arbitration agreements.

The frank language of the majority, the sharp criticisms voiced by the dissenters, and the actual results in the six cases together make clear that, whatever the intent of Congress (and the majority never addressed that issue), it is now abundantly clear that the FAA only

applies in Alabama to fact situations like the one presented in *Continental Grain Co. v. Beasley*, 628 So.2d 319 (Ala. 1993): where an out-of-state business ships huge volumes of materials into Alabama for local processing, then exports most of the finished product to out-of-state designations. Although Congress never intended to so limit the FAA, that is what the FAA has been reduced to in Alabama.

There is now a seventh decision which shows how the Alabama Supreme Court has dug in its heels. Only a few weeks ago, the court decided *Lorance v. Southern Health Corp.*, 1994 Ala. LEXIS 62 (Feb. 11, 1994) (a copy of which is appended hereto). In *Lorance*, it reversed a lower court which held the FAA applicable (even under the Supreme Court's new test) to enforce an arbitration clause in a contract between a Georgia corporation with no Alabama presence and a California physician. The agreement, neither negotiated nor executed in Alabama, required arbitration in Georgia of any dispute arising out of the agreement whereby the Georgia company helped the Californian relocate to Alabama and start a medical practice there, providing "surgical services *mainly* [but not exclusively] to Alabamians." The Alabama Supreme Court compared the facts to those in *Continental Grain*, and found them wanting.[3]

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[3] The court also drew on its recent decision in *First Real Estate Corp. v. Brown Marx Tower LP*, 620 So.2d 648 (Ala. 1993), declining to enforce an arbitration agreement between an Alabama corporation and two New York entities for management of the New Yorker's Alabama properties. Compare *Snyder v. Smith*, 736 F.2d 409, 417-18 (7th Cir. 1984), *cert. denied*, 469 U.S. 1037 (1985), the leading case applying a broad interpretation of

II. Respondent misstates the relevance of this Court's decision in *Perry v. Thomas*

Petitioners do not contend, as respondent suggests, that *Perry v. Thomas*, 482 U.S. 483 (1987), directly addressed the jurisdictional question raised here. Rather, petitioners point out that the Court's widely quoted description of the FAA, 482 U.S., at 490, as

> a statute that embodies Congress' intent to provide for the enforcement of arbitration agreements within the full reach of the Commerce Clause

was not casually uttered, and was indeed essential to the decision. *Perry* held that the FAA preempted provisions of the California Labor Code which exempted wage claims from arbitration. Difficulty arose from the fact that the Court had previously held the same anti-arbitration provisions not preempted under the federal securities laws and New York Stock Exchange rules requiring arbitration of disputes between a broker and his employer. The key question, then, was how the FAA differed from the federal securities laws. The Court found that the securities laws lacked any specific intent to prefer arbitration over other modes of resolving employment disputes, did not require nationwide uniformity of exchange housekeeping affairs, and addressed only a specific industry. The Court compared that scheme to the FAA – whose very first feature, said the Court, was that it

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"involving commerce" to compel arbitration of a dispute over the price to be paid for a deceased partner's interest in out-of-state property.

embodied Congress' intent to enforce arbitration agreements to the fullest extent of the Commerce Clause.

In short, although the Court addressed a preemption rather than jurisdiction issue, its decision rested squarely upon the conclusion that the FAA was intended to apply "within the full reach of the Commerce Clause." One can fairly view *Perry v. Thomas* as the linchpin of the body of law developed around the FAA by this Court since *Prima Paint*. For at page 489 it reiterated the teaching of *Moses H. Cone Mem. Hosp. v. Mercury Constr. Co.*, 460 U.S. 1, 24, that:

> Section 2 is a Congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary.

And it set that teaching in its proper jurisdictional context – namely, that the policy was to apply to all voluntary agreements choosing arbitration that Congress was able to reach under the Commerce Clause.

III. Respondent seriously understates the significance of the decision below

The decision below and its companion decisions have already had the immediate intended effect in Alabama. For all practical purposes, pre-dispute arbitration agreements voluntarily entered into are no longer enforceable in Alabama unless the facts are comparable to those in *Continental Grain*. The FAA has thus been amended no longer to apply to any dispute between an Alabama consumer and an out-of-state company. Indeed, under the new *Lorance* decision, it no longer applies to out-of-

staters inducing another out-of-stater to move his business to Alabama – so long as the agreement involves commercial conduct to be performed in Alabama, or commercial services to be provided "mainly to Alabamians." In short, Alabama has opted out of what *Perry v. Thomas* found was intended to be a uniform national scheme favoring arbitration in all matters within the full reach of the Commerce Clause.

But that does not exhaust the significance of the Alabama Supreme Court's reinterpretation of "involving commerce." A landmark article by arbitration authority Henry Strickland points out that in many states the meaning, for FAA purposes, of "involving commerce" has not yet been addressed or clearly resolved.[4] Moreover, he notes that a great many states have important substantive and procedural rules more hostile to arbitration than the body of federal law developed under the FAA. According to Professor Strickland's well-documented catalogue (set out at pages 400-409), even in states whose laws generally require enforcement of pre-dispute arbitration agreements, certain kinds of disputes (e.g., tort, insurance,

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[4] Strickland, "The Federal Arbitration Act's Interstate Commerce Requirement: What's Left for State Arbitration Law?," 21 *Hofstra L. Rev.* 385 (1991). After reviewing the jurisdictional decisions, the author concludes that "As the foregoing survey demonstrates, case law on the FAA's commerce requirement is ambiguous and erratic." *Id., at 454.* He also points out that this continuing uncertainty as to FAA jurisdiction itself invites and breeds threshold litigation, which – like the Alabama Supreme Court's reliance on a subjective "contemplation" test – defeats the FAA's objective of making arbitration speedy and uncomplicated. *Id., at 455-56.*

medical malpractice claims) are often consigned exclusively to the courts. Arbitration clauses are sometimes excluded from specific kinds of agreements – e.g., consumer financing transactions and loan agreements. And special validity pre-conditions are frequently imposed only on arbitration agreements, and on no other kinds of contracts – such as requiring signatures of both the party and his or her lawyer, or that the arbitration clause be separately initialed. Many of these restrictions are the progeny of precisely the residual suspicion and hostility toward arbitration that the FAA was intended to overrule.

Narrowing the reach of the FAA to apply only to transactions in which the parties "contemplated substantial interstate activity" in most cases insulates such hostile rules from the force of the federal statute. Many a state will be tempted to protect some such rule by adopting the Alabama approach.

It is important that this Court take this opportunity to declare that it meant what it said in *Perry v. Thomas*, and that as to arbitration agreements entered into voluntarily by the parties, the pro-arbitration policy reflected in the FAA applies to the full reach of the Commerce Clause.

CONCLUSION

For the reasons stated in this reply and in their original petition, the Court should grant the writ and review the decision below.

Respectfully submitted,

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March 9, 1994

SUPREME COURT OF ALABAMA

OCTOBER TERM, 1993-94

1930140

Ex Parte Thomas A. Lorance, M.D.
PETITION FOR WRIT OF MANDAMUS

(Re: Thomas A. Lorance, M.D.

v.

Southern Health Corporation of Hamilton, Inc., et al.)

(Marion Circuit Court, CV-93-57)

PER CURIAM.

The plaintiff, Thomas A. Lorance, M.D., petitions this Court for a writ of mandamus directing Judge Bobby R. Aderholt of the Marion County Circuit Court to set aside an order compelling arbitration of tort and breach-of-contract claims brought by Lorance against Southern Health Corporation of Hamilton, Inc. ("Southern Health"); Niles V. Floyd, vice president of Southern Health; and Frank Jenkins, M.D.[1] The issue is whether the arbitration clause in the professional services contract entered into by Lorance and Southern Health is enforceable under the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* ("FAA").

Predispute arbitration agreements are unenforceable under Alabama law, § 8-1-41, Alabama Code 1975; *Wells*

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[1] Jenkins is apparently an officer of Southern Health, although the petition does not indicate his title.

v. Mobile County Bd. of Realtors, Inc., 387 So. 2d 140 (Ala. 1980); however, if an arbitration clause is contained in a contract that involves interstate commerce, then the FAA preempts state law, and the clause is enforceable. *Ex parte Alabama Oxygen Co.*, 433 So. 2d 1158, *vacated, York Int'l v. Alabama Oxygen Co.*, 465 U. S. 1016, 104 S. Ct. 1260, 79 L. Ed. 2d 668 (1983); *Terminix Int'l Co. Ltd. Partnership v. Jackson*, [Ms. 1911842, August 13, 1993] ___ So. 2d ___ (Ala. 1993). The FAA makes certain arbitration clauses enforceable:

> "A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable."

9 U.S.C. § 2. " 'The FAA applies to a transaction within this state if the contract [1] involves interstate commerce and [2] contains an arbitration clause voluntarily entered into by the parties.' " *Lopez v. Home Buyers Warranty Corp.*, [Ms. 1920330, August 20, 1993] ___ So. 2d ___ (Ala. 1993) (quoting *A. J. Taft Coal Co. v. Randolph*, 602 So. 2d 395, 397 (Ala. 1992)). The test of whether a contract containing an arbitration clause involves interstate commerce is whether the parties to the contract contemplated substantial interstate activity at the time they entered into the contract. *Ex parte Jones*, [Ms. 1920249, July 16, 1993] ___ So. 2d ___ (Ala. 1993).

In March 1992, Lorance and Southern Health entered into a "Net Income Guarantee Agreement," under which

Lorance agreed to establish a medical practice in Hamilton, Alabama, in exchange for Southern Health's promise to help Lorance establish his practice and to subsidize his net practice income during the term of the contract by paying him $15,000 per month. This contract contained an arbitration clause, which required that all claims or controversies arising out of or relating to the contract be settled by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association and that the arbitration be conducted in Atlanta, Georgia.

Southern Health is a Georgia corporation with its corporate offices in Atlanta, Georgia. Southern Health's officers, G. Frank Jenkins, M.D., president; Phillip H. Eastman III, vice president/secretary; Mike Hall, executive vice president; and Susan Jennings negotiated that Net Income Guaranty Agreement from Southern Health's corporate offices in Atlanta, Georgia; Lorance at that time was residing in California. According to the affidavits of Jenkins and Eastman, the final act making the contract enforceable was Eastman's execution of the contract in Atlanta.

In its written order, the circuit court held that Lorance and Southern Health contemplated substantial interstate activity in the performance of the contract, noting that when the contract was negotiated, Lorance was a California resident and Southern Health was a Georgia corporation; that the negotiations took place, and the contract was executed, outside Alabama; that the income guarantee payments to Lorance by Southern Health originated in Atlanta, Georgia; and that Lorance and agents of Southern Health communicated numerous

times concerning the establishment of Lorance's practice, e.g., they communicated in regard to marketing, medical equipment, and supplies.

Citing *First Real Estate Corp. v. Brown Marx Tower Limited Partnership*, 620 So. 2d 648 (Ala. 1993), Lorance argues that the circuit court erred in compelling arbitration and that, notwithstanding the communications between the parties across state lines during the negotiation of the contract, the purpose or "focus" of the contract was to subsidize and assist Lorance in establishing a medical, surgical practice in Hamilton, Alabama. Therefore, Lorance contends, the activity that the parties contemplated was purely local.

Citing *Continental Grain Co. v. Beasley*, [Ms. 1920241, July 16, 1993] ___ So. 2d ___ (Ala. 1993), Southern Health, Jenkins, and Floyd counter, arguing that it is the scope of the contract, not the *locus actus* – place of performance – that determines the applicability of the FAA. Therefore, they say that, because the contract was negotiated while neither party to the contract was a resident of Alabama and because Southern Health's performance under the contract was directed from its corporate offices in Atlanta, Georgia, the contract involved substantial interstate activity.

In *First Real Estate Corp., supra*, the issue was whether a commercial real estate management agreement involved interstate commerce for purposes of applying the FAA. First Real Estate Corporation of Alabama, Inc., an Alabama corporation, entered into separate management agreements with Brown Marx Tower Limited Partnership (a limited partnership organized under the laws of New

York) and Bell Building Group, Inc. (an Alabama corporation with its principal place of business in New York), for the management of Brown Marx Tower in Birmingham, Alabama, and the Bell Building in Montgomery, Alabama. Under these management agreements, which were negotiated in Alabama, First Real Estate was to manage the Brown Marx Tower and the Bell Building. Brown Marx Tower Limited Partnership and the Bell Building Group brought an action against First Real Estate, alleging fraud, breach of contract, breach of fiduciary duty, gross negligence, and tortious interference with business relations. All of these allegations concerned actions or events that occurred in Alabama and that arose from obligations that were to be performed solely in Alabama. Holding that the management agreements did not involve interstate commerce, the Court stated that the "mere use of the telephone and mail by persons in different states to communicate about activity that is purely local is too slight to constitute such a nexus." 620 So. 2d at 649.

Although the contract in this case was not negotiated in Alabama, the holding in *First Real Estate Corp.* persuades us that the communications between the parties during both the negotiation of the contract and its performance concerned an activity that the purely local, namely, the establishment of a surgical practice in Hamilton, Alabama. We hold, therefore, that these communications do not, by themselves, support an inference that the parties contemplated substantial interstate activity when they entered into the "Net Income Guarantee Agreement." Like the service contracts in *First Real Estate Corp.*, which were entered into by companies either organized or having their principal place of business in

another state, for the management of commercial real estate located in Birmingham and Montgomery, Alabama, the professional service agreement in this case was entered into for the purpose of establishing a surgical practice in Hamilton, Alabama. Although the parties to the agreements in *First Real Estate Corp.* and the parties to the agreement in this case engaged in communications across state lines, the activity toward which their contracts and their efforts were directed was purely local.

Southern Health contends that the parties contemplated substantial interstate activity and that this contention is supported by evidence indicating that Southern Health's agents, working in Atlanta, Georgia, directed that corporation's performance under the contract. We conclude that *Continental Grain Co. v. Beasley, supra,* does not support Southern Health's argument. *Continental Grain Co.* involved an arbitration agreement between Continental Grain Company (a poultry products retailer) and a group of Alabama chicken growers. Although the growers' performance under the contract consisted solely of growing chickens in Alabama during the period between hatching and processing, the Court held that the parties had contemplated substantial interstate activity in performing their contractual obligations because they were engaged in the production of poultry, 90 percent of which was to be sold out of state in interstate commerce.

Southern Health relies heavily on this Court's statement in *Continental Grain Co.* that the place of performance under the contract is not dispositive and that it is the "scope of the contract," and not the *locus actus,* that determines the applicability of the FAA. The Court in *Continental Grain Co.* made it clear that although the

growers' performance under the contract occurred solely in Alabama, their performance under the contract was but one part of a larger production process that contemplated the ultimate sale of 90 percent of the poultry in interstate commerce. Therefore, the *Continental Grain Co.* Court concluded, the scope of the contract encompassed substantial interstate activity. In this case, however, although some of Southern Health's performance under the contract was directed by its agents from Atlanta, Georgia, the scope of the Net Income Guarantee Agreement was not so extensive as to include substantial interstate activity. The scope of the contract consisted principally of establishing a medical practice in Hamilton, Alabama, to provide surgical services mainly to Alabamians in Marion County.

Based on the foregoing, we hold that the circuit court erred in compelling arbitration of Lorance's claims against Southern Health under the Net Income Guaranty Agreement. Therefore, the petitioner is entitled to the writ.

WRIT GRANTED.

Hornsby, C. J., and Almon, Shores, Steagall, Kennedy, Ingram, and Cook, JJ., concur.

Houston, J., dissents.

Ex parte Thomas A. Lorance, M.D.

HOUSTON, JUSTICE (dissenting).

I would deny the writ. *Continental Grain Co. v. Beasley,* [Ms. 1920241, July 16, 1993] ___ So.2d ___ (Ala. 1993).